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LINKING ESG AND CREDIT RISK: EVIDENCE ON FINANCIAL PERFORMANCE AND STOCK MARKET RETURNS IN ASEAN BANKING SECTOR

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ABSTRACT

This research seeks to examine the influence of Environmental, Social, and Governance (ESG) factors and Non-Performing Loans (NPLs) on financial performance and their effects on stock returns within the ASEAN banking industry. The impetus for this study arises from the growing emphasis on sustainability in the financial sector and the difficulties presented by credit risk, both of which are vital elements influencing bank performance and appeal to investors. The study population consists of banking institutions from five ASEAN nations—Indonesia, Malaysia, Singapore, Thailand, and the Philippines—over the period of 2021–2023. A total of 102 valid observations were gathered through purposive sampling following the outlier examination. The variables analyzed consist of ESG, NPL, financial performance assessed by Return on Assets (ROA), and stock returns, all obtained from Bloomberg. Analysis was conducted with SmartPLS software. The results show that ESG has a positive and significant effect on both financial performance and stock returns, whereas NPLs have a negative and significant effect on these results. Conversely, stock returns are not notably influenced by financial performance. These findings indicate that ASEAN investors prioritize factors beyond profitability, emphasizing the significance of sustainability practices, effective governance, and management of credit risk. This study adds to the existing literature by supporting stakeholder theory, which asserts that the success of a corporation depends on harmonizing the interests of all stakeholders. The results urge banks to strengthen ESG practices and refine credit risk management to enhance performance and sustain investor trust in the capital markets.

Keywords: *Environmental, Social, and Governance, Financial Performance, Non-Performing Loan, Stock Return*

1. INTRODUCTION

Banking is an economic sector that significantly contributes to delivering financial services and fostering economic development. According to Law Number 7 of 1992 regarding Banking, which has undergone multiple revisions, most recently with Law Number 4 of 2023 about the Development and Strengthening of the Financial Sector, a bank is classified as a business entity that gathers funds from the public in the shape of deposits and then redistributes them as credit, financing, or various financial instruments to enhance community welfare (OJK, 2025). Joseph Schumpeter, a classical economist, also highlighted the significance of this sector by asserting that banks are essential for economic development, as they are responsible for distributing funds to the most innovative entrepreneurs, enabling them to generate innovation and stimulate economic growth (Schumpeter, 1934). Consequently, the condition of the banking industry is frequently viewed as an indicator of a nation's economic well-being.

However, in recent years, banking in the ASEAN region has faced pressure due to global and regional economic dynamics. The decline in benchmark interest rates in various countries throughout 2023–2024 is one sign of a slowdown in economic activity. The Asian

Development Bank (ADB) report shows that the growth projection for the Southeast Asian region for 2023 has been revised from 4.6% to 4.3%, and for 2024 from 4.8% to 4.7%. For example, Malaysia's growth projection was revised down from 4.5% to 4.2% in 2023, while Thailand's was adjusted from 3.5% to 2.5% (Petruang, 2024). This slowdown has implications for the declining profitability of the banking sector, which requires banks to maintain their financial performance while strengthening their competitiveness in uncertain conditions. One commonly used performance measure is Return on Assets (ROA). However, profitability is not the only factor that determines the stability and sustainability of banking performance; there are also non-financial variables that have an impact, one of which is Environmental, Social, and Governance (ESG), as well as credit risk factors such as Non-Performing Loans (NPL).

In recent years, ESG has become a strategic issue that has attracted significant attention from companies, investors, regulators, and the general public. ESG is not only a non-financial indicator but also a strategic instrument that can influence a company's image, sustainability, and market value (Liu & Xie, 2024; Shan et al., 2024). Its application in the banking sector is often manifested through Corporate Social Responsibility (CSR) programs, sustainable financial services, and compliance with governance standards. The European Commission defines CSR as voluntary initiatives by companies to create a better society by considering social and environmental aspects in their operations (Liuadaa et al., 2023). However, in practice, there are still challenges, where banks have considerable discretion in classifying their investments as “ESG,” so the accuracy of assessments is often questioned (Bruno et al., 2024). Nevertheless, the growing trend of sustainable financial products and services—such as green savings instruments, environmental consulting services, and climate products—shows that ESG is increasingly seen as an important managerial strategy, not just a regulatory obligation (Horobet et al., 2025; Winarso, 2025).

Conversely, credit risk continues to be a significant obstacle for the banking industry, as indicated by the NPL ratio. Loans are deemed non-performing when principal and interest payments are overdue by 90 days or more, or when there are signs that future payments may not be fully received (Giammanco et al., 2023). Elevated NPLs diminish asset quality, impair profitability, and erode investor trust in banks. The 2008 worldwide financial downturn demonstrated that significant credit risk can initiate macroeconomic instability and diminish the stability of the financial industry (Gupta & Bansal, 2024). Consequently, managing non-performing loans is essential for preserving bank stability. From an ESG standpoint, responsible lending practices represent the bank’s dedication to sustainability for stakeholders and initiatives to prevent financial crises (Winarso, 2025).

It is crucial to evaluate how ESG and NPL concurrently influence banking financial performance and how this performance affects stock returns. Prior research has investigated the connection among ESG, NPL, financial results, and stock returns; however, the majority of these studies were done in isolation and concentrated on developed nations (Utama et al., 2024; Rizqullah & Wibowo, 2024; Fu & Li, 2023). This gap in research creates chances for more in-depth studies, especially in the ASEAN area, which exhibits distinct economic dynamics and market traits.

This study aimed to address these questions: Does the adoption of ESG and credit risk management (NPL) influence banking financial performance, and does financial performance subsequently impact stock returns? This study, leveraging banking data from five ASEAN nations (Indonesia, Malaysia, Singapore, Thailand, and the Philippines) during 2021–2023, aims to theoretically enrich the literature while providing practical insights for banking management, investors, and regulators in addressing sustainability and credit risk issues within the financial sector.

Stakeholder Theory

This research is based on stakeholder theory, first introduced by Freeman in 1984. The theory highlights that companies ought not to focus exclusively on shareholder interests but instead must balance the needs of all parties affected by their activities. These entities—known as stakeholders—encompass employees, managers, board members, suppliers, creditors, debtors, shareholders, rivals, customers, and the local community (J. Liu & Xie, 2024). Integrating and revealing ESG practices in corporate reports is one method of recognizing stakeholder concerns. This illustrates that businesses are motivated not just by profit goals but also by a dedication to their wider social obligations. These initiatives contribute to forming a favorable corporate image, indicating to stakeholders that the organization is run ethically and efficiently. As a result, confidence among stakeholders often increases, resulting in more investment and collaboration, which can improve stock returns. On the other hand, high Non-Performing Loan (NPL) ratios can strain relationships with stakeholders and indicate fundamental financial instability. A rise in NPLs indicates an elevated credit risk, potentially obstructing a firm's capacity to fulfill its responsibilities to stakeholders, thereby affecting its financial performance and anticipated stock returns.

Environmental, social, and governance

The idea of ESG, first presented by the United Nations Principles for Responsible Investment (UNPRI) in 2006, prompts investors to thoroughly evaluate how environmental, social, and governance elements affect the worth and sustainability of their investments (Hoepner et al., 2021). Over time, this viewpoint has developed into a key factor in worldwide investment choices. ESG acts as a framework for assessing how well a company, including financial entities like banks, integrates sustainability principles into its strategic approach. As noted by S. Liu et al. (2023), the ESG framework consists of three main pillars: Environmental, Social, and Governance. The ecological aspect analyzes how organizations handle their direct environmental impact and the ecological effects of the initiatives they endorse. The social aspect centers on a company's interactions with different stakeholders, such as employees, clients, and local communities. Simultaneously, the governance facet pertains to corporate supervision, including factors like transparency, board structure, and risk management strategies.

Non-Performing Loan (NPL)

NPL is an indicator of credit risk. A high NPL value can reduce profitability and threaten the stability of a bank. According to Bank Indonesia regulations (2013), the NPL limit is 5%. If it exceeds this limit, the company is declared unhealthy and the bank's performance declines. Non-performing loans can cause serious problems for lending companies. Because these loans do not generate income, the funds lent are likely to be lost, causing cash flow problems for the company.

Financial Performance

Financial performance is an analysis used to examine whether a company's financial management complies with financial implementation rules in a proper and correct manner (Hutabarat, 2021). According to Beaver (1967), a company's performance is the result of many individual decisions made continuously by the company's management. These decisions include investment, operational, and financing decisions. In analyzing financial performance, there are several ratios that can be used, one of which is Return on Assets (ROA). The ROA ratio is used to analyze performance because, in addition to looking at profits, it is also better to look at the assets and equity owned by the company (Singh et al., 2021).

Stock Return

Stock return is the income received by investors from their investments. According to Devita & Arviana (2023), in investment, returns can be categorized into two types. First, realized returns, which are actual profits calculated based on historical data and serve as a benchmark for company performance. Second, expected returns, which are the projected level of profit that investors will receive in the future.

The Relationship between ESG, Financial Performance, and Stock Returns

Awareness of environmental issues among the public has been growing consistently, leading to the development of various community initiatives aimed at safeguarding and preserving the local environment. One example of this effort is the implementation of ESG practices. Similarly, in the corporate sector, adopting ESG principles demonstrates a firm's dedication to integrating sustainability into its business strategy to create long-term value. Robust ESG performance is now recognized not just as an extra cost, but as a strategic investment that can improve operational efficiency, reduce risks, bolster corporate reputation, and increase access to capital markets. Stakeholder theory posits that corporate managers should harmonize the various interests of all stakeholders by gaining a comprehensive understanding of those directly or indirectly associated with the organization's operations. This method aids in reducing managerial risk (Liu & Xie, 2024). This perspective is underpinned by stakeholder theory, which suggests that a company's success depends not just on shareholder contentment but also on its ability to align the interests of all stakeholders. Consistent with this viewpoint, businesses are accountable for the ecological impacts of their activities. By revealing environmental data in their yearly reports, companies can improve ties with local communities while boosting their trustworthiness with external investors and the general public (Prabawati & Rahmawati, 2022). These results are supported by earlier research carried out by Winarso (2025), Aydoğmuş et al. (2022), and Strekalina et al. (2023), which show that ESG disclosure has a considerable positive effect on banks' financial performance, thus validating the suggested hypothesis. Likewise, Loan et al. (2024) discovered that revealing ESG-related policies—particularly concerning environmental and governance aspects—has a beneficial impact on banking financial results. These findings are relevant to stakeholder theory, highlighting that companies should reconcile their financial performance goals with the expectations and welfare of a wider array of stakeholders (Yudaruddin et al., 2025).

Moreover, previous studies show that better ESG performance leads to decreased stock market volatility and increased market liquidity, resulting in higher stock returns (Liu et al., 2023; Yin et al., 2023).

H1a: Environmental, social, and governance have a positive effect on banking financial performance

H1b: Environmental, social, and governance have a positive effect on stock returns

The Relationship between NPL, Financial Performance, and Stock Returns

Non-Performing Loans are those loans for which the borrower has not made interest or principal repayments within a specified timeframe. Consequently, when the NPL value is elevated, it indicates that the profitability of the bank has decreased and the company's performance has worsened, as not only are the loan funds unrecovered, but the company also loses interest income, which impacts its ability to distribute credit effectively. According to stakeholder theory, the effect of Non-Performing Loans extends beyond being just an internal financial issue. A high NPL value indicates that the company has not effectively managed its dealings with debtors, leading to a cascading impact that negatively affects various stakeholders, including reduced customer trust in depositing money, possible dividend losses for shareholders, risks to employee well-being, and barriers to community lending. Consequently, NPLs represent a reflection of stakeholder relationship risks that may harm the company's overall performance and sustainability.

Moreover, a greater NPL value indicates a poorer state of the bank, as it demonstrates a diminished capacity to identify viable borrowers, leading to reduced earnings, lower investor interest, diminished share demand, and causing a drop in share prices (Sudarno et al., 2021). Numerous researchers contend that non-performing loans adversely affect company performance, as demonstrated in the studies by Luana et al. (2024) and Jathurika (2019). Previous research by Boussaada et al. (2023) supports this finding, indicating that a rise in the NPL ratio significantly hampers bank performance. In the same vein, a study by Lawrence et al. (2024) revealed that elevated NPL levels diminish return on equity, profitability, or overall bank financial performance, which in turn decreases bank efficiency.

Moreover, earlier research has shown that non-performing loans negatively impact stock returns (Siagian et al., 2024; Sudarno et al., 2021).
H2a: Non-performing loans have a negative impact on banking financial performance
H2b: Non-performing loans have a negative impact on stock returns.

The Relationship between Financial Performance and Stock Returns
A company's performance may be assessed through ROA, since this ratio indicates how effectively the firm utilizes its assets for the advantage of all stakeholders. According to Stakeholder Theory, a company's sustainability in the long term relies on its capacity to generate value for every stakeholder. A high ROA shows that the company can produce profits from its assets, enabling reinvestment, offering competitive salaries for staff, delivering quality products to consumers, sustaining solid relationships with suppliers and the community, which serves as an encouraging sign for investors, thus raising share prices and boosting stock returns. This assertion aligns with the findings of Devita & Arviana (2023) and Lasa & Mustafa (2023).
H3: Banking financial performance has a positive effect on banking stock returns

Based on the development of the above hypothesis, we propose the following research model:

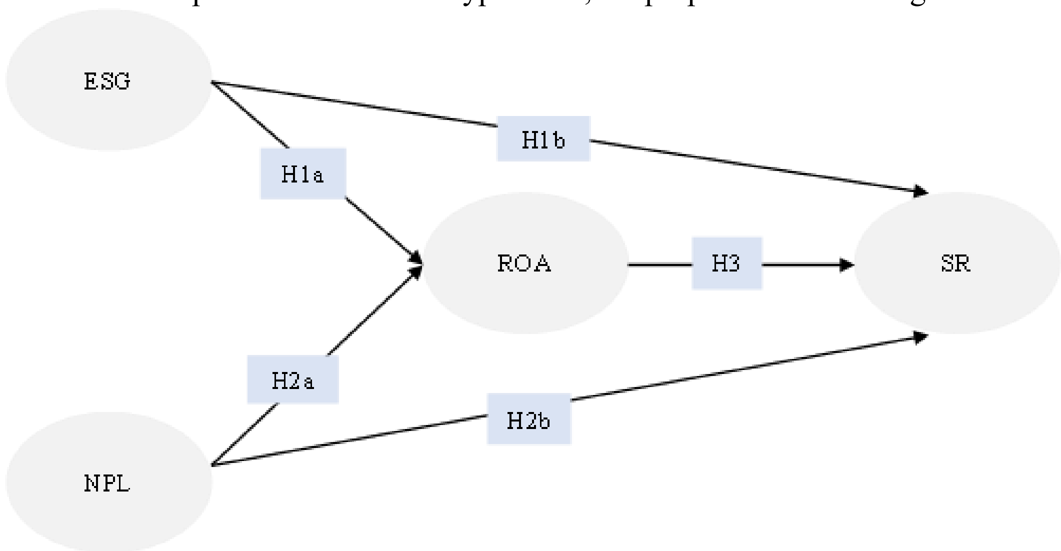

Figure 1. Research model

2. RESEARCH METHOD

This study's population includes the financial statements of ASEAN banks from five nations—Indonesia, Malaysia, Singapore, Thailand, and the Philippines—spanning the years 2021 to 2023. The study's variables, such as the Environmental, Social, and Governance (ESG) score, Non-Performing Loan (NPL) ratio, Return on Assets (ROA), and stock returns, were sourced from the Bloomberg database for the identical timeframe. A targeted sampling method was utilized for gathering data, resulting in a sum of 639 observations. After applying sample selection criteria—namely, the availability of ESG data for three consecutive years (2021–2023)—and eliminating outliers, a total of 102 valid observations was finalized for analysis.

The assessment of variables in this research depended solely on quantitative secondary data sourced from the Bloomberg database covering the years 2021 to 2023. All variables, including both dependent and independent—specifically stock return, Return on Assets (ROA), Environmental, Social, and Governance (ESG), and Non-Performing Loans (NPL)—were assessed using standardized proxy scores released by Bloomberg. The application of these indicators demonstrates that the researchers utilized pre-calculated and publicly accessible data, effectively reflecting the performance of each variable without the need for manual calculations from company financial statements.

This research utilizes a quantitative methodology. Data analysis and processing were performed utilizing SmartPLS software employing the Structural Equation Modeling (SEM) approach. The SEM method is mainly employed in exploratory studies to support theory formulation by concentrating on clarifying the variation of the dependent variable in a suggested framework (Hair et al., 2021). Sarker et al. (2024) state that SmartPLS serves as a dependable analytical instrument for analyzing intricate relationships between variables and for developing predictive models in various fields, such as marketing, management, and the social sciences. In the SmartPLS framework, the analysis consists of two primary phases: the measurement model and the structural model. The external model evaluates the constructs' reliability and validity, whereas the internal model analyzes the overall fit of the model and tests the hypotheses.

3. RESULTS AND DISCUSSIONS

Tabel 1. Construct Reliability and Validity
Source: output SmartPLS v.4

	Cronbach's Alpha	CR (rho_a)	CR (rho_c)	AVE
ESG	0,726	0,845	0,805	0,590
NPL	0,931	0,756	0,954	0,874
ROA	0,845	0,857	0,905	0,761
SR	0,713	0,782	0,792	0,646

Note: ESG: Environmental, social, and governance; NPL: Non-performing loan; ROA: Return on assets; SR: Stock return

According to the findings of construct reliability and validity assessments, every construct in this research demonstrated sufficient results to continue with additional analysis. Cronbach's Alpha values for ESG (0.726), NPL (0.931), ROA (0.845), and SR (0.753) suggest good internal consistency below the 0.70 threshold, whereas the Composite Reliability (CR) values for each construct, including rho_a and rho_c, are satisfactory since they exceed 0.70. This suggests that the metrics for each construct reliably assess the intended idea. Moreover, the Average Variance Extracted (AVE) values for ESG (0.590), NPL (0.874), ROA (0.761), and

SR (0.646) exceed the 0.50 threshold, signifying strong convergent validity. Therefore, all constructs in this research are demonstrated to be valid and reliable, rendering them appropriate for structural model analysis via SmartPLS.

Tabel 2. Fornell-Larcker Criterion
Source: output SmartPLS v.4

	ESG	NPL	ROA	SR
ESG	0,768			
NPL	0,352	0,935		
ROA	0,517	0,208	0,873	
SR	-0,053	-0,051	-0,316	0,668

Note: ESG: Environmental, social, and governance; NPL: Non-performing loan; ROA: Return on assets; SR: Stock return

A discriminant validity analysis of the model indicates no discriminative issues. The first indicator of discriminant validity criteria, Fornell-Larcker, does not show any issues and demonstrates that all factors are significant (see Table 2).

Table 3. Heterotrait–Monotrait ratio (HTMT)
Source: output SmartPLS v.4

	ESG	NPL	ROA	SR
ESG				
NPL	0,314			
ROA	0,505	0,207		
SR	0,659	0,447	0,617	

Note: ESG: Environmental, social, and governance; NPL: Non-performing loan; ROA: Return on assets; SR: Stock return

The final discriminant indicator, HTMT, also demonstrates no discriminant validity problems, as all construct values are below 0.85 – see Table 3 (Henseler et al., 2015).

Hypothesis Testing

Figure 2 presents the results of the hypotheses analysis. The findings of the hypotheses for this study indicate that *H1a* (β = 0.56, $p < 0.05$), *H1b* (β = 0.58, $p < 0.05$), *H2a* (β = -0.02, $p < 0.05$), *H2b* (β = -0.16, $p < 0.05$) was supported, while *H3* (β = -0.04, $p > 0.05$) was not supported.

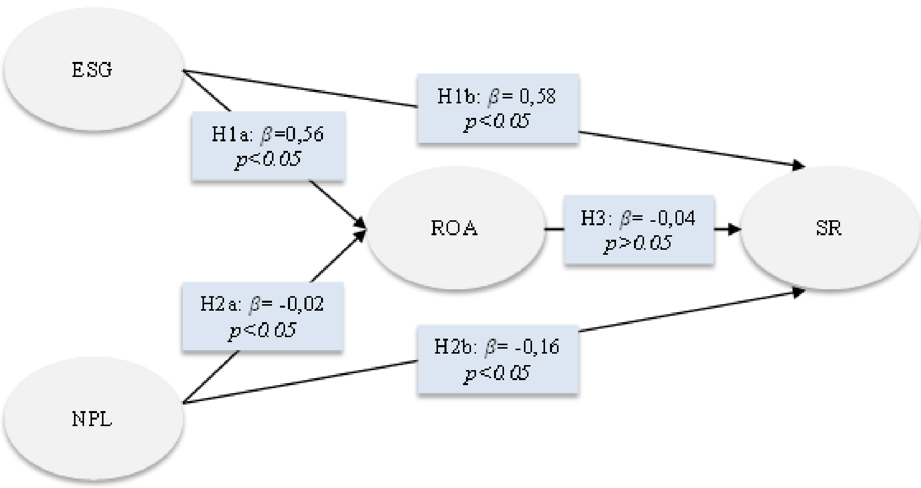

Figure 2. Results of the research model
Source: output SmartPLS v.4

The findings reveal that ESG performance has a positive and significant effect on banks' financial performance ($\beta = 0.58$, $p < 0.05$), **thus confirming H1a**. This result suggests that stronger implementation of ESG principles is associated with better financial outcomes. In other words, integrating sustainability considerations into corporate strategy enhances stakeholder confidence and generates tangible economic value.

Practically, banks that effectively implement ESG initiatives tend to gain greater trust from investors, customers, and regulators. Such credibility contributes to improved cash flow, a broader customer base, and reduced capital costs due to lower perceived risk. Furthermore, ESG-oriented strategies can improve operational efficiency through energy savings, enhanced environmental risk management, and greater transparency in governance.

These findings are consistent with previous research demonstrating a positive association between ESG performance and corporate financial outcomes (Friede et al., 2015; Velte, 2017). Similar to these studies, the present results reinforce the view that ESG adoption serves as a strategic long-term investment that strengthens business resilience while delivering measurable financial benefits. Specifically within the banking sector, integrating social responsibility and sound governance practices mitigates reputational, legal, and credit risks—factors that ultimately contribute to higher profitability and sustainable growth.

Furthermore, these findings are consistent with stakeholder theory, which posits that firms are accountable not only to shareholders but also to a broader set of stakeholders (Bonnafous-Boucher & Rendtorff, 2016). By meeting stakeholder expectations through effective ESG implementation, banks enhance their social legitimacy and simultaneously improve financial outcomes (Zairis et al., 2024). These results therefore extend existing empirical evidence that positions ESG not merely as an ethical or regulatory requirement, but as a strategic framework for creating long-term corporate value.

The results also demonstrate that ESG performance positively and significantly affects stock returns ($\beta = 0.58$, $p < 0.05$), **confirming H1b**. This finding suggests that ESG adoption in the banking sector yields not only social and environmental benefits but also tangible market advantages, as reflected in stronger investor confidence and higher stock performance. In line with previous studies emphasizing the market's favorable response to sustainable business practices, these results highlight ESG as a driver of both reputational capital and financial growth.

According to stakeholder theory, firms have responsibilities not only to shareholders but also to broader stakeholder groups, including customers, employees, regulators, and the wider community. By meeting stakeholder expectations through sustainable and ethical practices, banks can strengthen their social legitimacy, enhance corporate reputation, and cultivate market trust. This enhanced trust translates into greater investor confidence and increased demand for bank stocks, thereby contributing to higher stock returns.

Investors often perceive firms with consistent ESG implementation as more resilient and better equipped to manage non-financial risks such as reputational, legal, and regulatory risks. This observation aligns with the findings of Liu et al. (2023) and Yin et al. (2023), who reported a positive relationship between ESG performance and stock returns. Similarly, Velte (2017) found that companies with stronger ESG ratings tend to achieve higher market valuations due to their perceived long-term growth potential. Moreover, Fatemi et al. (2018) emphasized that transparent ESG disclosures enhance stakeholder trust, which, in turn, positively influences stock valuation.

In the banking sector, these relationships are particularly significant given the industry's central role in managing and channeling public funds. Strong ESG performance fosters customer confidence, promotes investor loyalty, and helps reduce capital costs by lowering perceived risk. Consequently, ESG should be viewed not merely as an ethical or regulatory requirement but as a strategic business framework that enhances stock performance by addressing stakeholder interests.

The analysis further reveals that Non-Performing Loans (NPLs) have a significant negative effect on banks' financial performance ($\beta = -0.02$, $p < 0.05$), **confirming H2a**. This result indicates that higher NPL ratios are associated with weaker financial outcomes, which is consistent with the logical expectation that declining asset quality reduces interest income, increases provisions for credit losses, and ultimately erodes profitability.

From the perspective of risk management theory, Non-Performing Loans (NPLs) reflect the inherent credit risk embedded in banking intermediation activities. Elevated credit risk exerts downward pressure on profit margins, as banks must absorb losses from defaulted loans. Consequently, deteriorating asset quality adversely affects key indicators of financial performance, such as Return on Assets (ROA), since declining loan quality directly undermines profitability and overall operational efficiency.

These findings are consistent with previous research. Chaibi and Ftiti (2015) demonstrated that NPLs negatively affect bank profitability across both developed and developing economies. Similarly, Sufian and Habibullah (2009) found that higher NPL ratios diminish a bank's profit-generating capacity due to the need for greater loan-loss provisions. Further evidence from Luana et al. (2024) and Jathurika (2019) confirmed that elevated NPL levels are inversely associated with financial performance, reinforcing the argument that weak asset quality poses a substantial threat to bank profitability.

The results also align with agency theory, which underscores management's responsibility to preserve credit quality through effective monitoring and control mechanisms. Failure to manage NPLs efficiently not only reduces shareholder value but also undermines the confidence of other stakeholders, including customers and investors. Thus, increasing NPL ratios can signal weaknesses in risk management and deficiencies in corporate governance. Overall, the findings affirm that asset quality constitutes a fundamental determinant of financial performance, and maintaining low NPL levels through robust credit risk management and sound governance is vital for sustaining profitability and stakeholder trust.

Additionally, the analysis reveals that NPLs exert a significant negative effect on stock returns ($\beta = -0.16$, $p < 0.05$), **confirming H2b**. This outcome suggests that rising NPL ratios not only erode bank profitability but also deteriorate investor perceptions and confidence, leading to lower stock valuations. The market interprets high NPL levels as indicators of deteriorating asset quality and elevated credit risk, prompting investors to reassess the bank's financial stability and long-term prospects..

From a theoretical perspective, these findings can be explained through signaling theory. A high level of Non-Performing Loans (NPLs) transmits a negative signal to the market, suggesting weaknesses in risk management, deteriorating asset quality, and an increased likelihood of credit losses. Investors interpret such conditions as unfavorable indicators of future bank performance, leading to declining stock prices and lower stock returns. In this regard, NPLs serve as a key risk indicator that investors consider when making investment decisions.

From the standpoint of agency theory, elevated NPL ratios may also reflect managerial inefficiency in credit oversight or opportunistic behavior, such as granting high-risk loans without adequate assessment. These practices undermine the trust of shareholders and other stakeholders, ultimately weakening stock performance in the capital market.

Empirically, the results align with previous research. Vithessonthi (2016) demonstrated that NPLs negatively influence firm value and bank stock returns across Asian markets. Similarly, Sudarno et al. (2021) found that an increase in NPLs reduces investor confidence, resulting in lower stock returns. Subsequent studies by Siagian et al. (2024) and Sudarno et al. (2021) reaffirm that higher NPL ratios are consistently associated with weaker stock market performance. Collectively, this body of evidence underscores that deteriorating asset quality diminishes both internal financial stability and external market valuation.

These findings highlight the critical role of NPL management in banking operations—not only to safeguard financial soundness but also to preserve the market attractiveness of bank shares. Banks that maintain high-quality loan portfolios are generally perceived as more stable and reliable, thereby enhancing investor confidence and supporting stronger stock performance.

However, the analysis also reveals that banking financial performance does not have a significant effect on stock returns ($\beta = -0.04$, $p > 0.05$), thus **rejecting H3**. This result suggests that investors may not automatically translate improved profitability or financial indicators into higher stock valuations. Instead, stock returns are likely influenced by broader factors such as market sentiment, macroeconomic conditions, and non-financial dimensions—including ESG performance and risk exposure.

Within the framework of stakeholder theory (Freeman, 2010), firms are accountable not only to shareholders but also to a wider array of stakeholders, including customers, regulators, employees, and the community at large. Accordingly, while financial performance reflects a bank's profit-generating ability, investors increasingly emphasize non-financial factors that represent stakeholder interests when assessing firm value. Elements such as sustainability initiatives (ESG), sound corporate governance, service quality, and institutional stability are now viewed as more critical determinants of investment appeal and market valuation than short-term profitability alone.

These findings diverge from those of Devita and Arviana (2023) as well as Lasa and Mustafa (2023), who concluded that stock returns are significantly influenced by financial performance indicators such as ROA. In contrast, the present study indicates that market valuation in the banking sector is increasingly shaped by the institution's ability to meet long-term stakeholder expectations, rather than being driven solely by short-term financial outcomes.

This perspective further clarifies why the relationship between financial performance and stock returns is not statistically significant. Investors may perceive high short-term profits as unsustainable when they are not accompanied by effective risk management, regulatory compliance, and robust environmental and social responsibility. Accordingly, stakeholder theory offers a compelling explanation: stock returns are more strongly influenced by a firm's ability to generate balanced and enduring value for all stakeholders rather than by the pursuit of short-term profit maximization for shareholders alone.

4. CONCLUSIONS AND SUGGESTIONS

The study's results suggest that Environmental, Social, and Governance (ESG) factors have a positive and considerable impact on the financial performance and stock returns of banks. This finding supports the idea that incorporating sustainability principles boosts not only profitability but also the bank's image and appeal to investors. In contrast, Non-Performing Loans (NPLs) show a notable negative correlation with financial performance and stock returns, indicating that an increase in non-performing loans results in worsening asset quality, diminished earnings, and decreased market returns. The analysis shows that financial performance does not greatly affect stock returns, indicating that investors in the ASEAN banking sector take into account factors beyond just financial metrics in their investment choices. Rather, non-financial factors—like sustainability pledges, governance standards, and general sector stability—seem to significantly influence investor perceptions and market valuation.

This research has its limitations. Initially, the observation timeframe covers just three years (2021–2023), limiting the capacity to comprehensively understand the long-term interactions between ESG, NPL, and financial performance in relation to stock returns. Secondly, this research's scope is limited to the banking sector in five ASEAN nations. As a result, the results might not be fully applicable to other industries or to nations that have varying market conditions and regulatory settings, like developed countries with stronger ESG policies. Third, the variables analyzed in this research are confined to ESG, NPL, ROA, and stock returns. Additional potentially relevant factors—including macroeconomic indicators (e.g., inflation, GDP growth, and interest rates), the level of banking digitalization, and the robustness of internal governance—were excluded from the model. This exclusion might limit the study's capacity to offer a more comprehensive view of the elements affecting banking performance and stock market results. Finally, control variables like company size were excluded, which could influence the reliability of the findings. Notwithstanding these limitations, the research provides valuable insights into the connections between sustainability, risk management, and market performance within the ASEAN banking environment. Nevertheless, the findings must be interpreted cautiously and not extrapolated beyond the particular scope of this study.

These results allow for several recommendations. Banking management must incorporate ESG implementation into their long-term strategic plans, as research indicates it improves financial outcomes and boosts investor trust. Simultaneously, managing the NPL ratio should continue to be a primary focus by implementing careful lending practices, closer supervision of debtors, and utilizing technology-driven risk assessment tools. Secondly, investors are advised to assess banking stocks not just via traditional financial metrics but also by taking into account sustainability outcomes and the quality of risk management. Third, regulators ought to create policies that enhance transparency in ESG reporting and implement strict supervision of credit quality to maintain the stability of the financial system. Ultimately, it is recommended that forthcoming research integrate macroeconomic factors—such as inflation, interest rates, and economic growth—or involve moderating variables like banking digitalization, while broadening the focus to additional sectors. This would enable a broader comprehension of the factors that affect financial and market outcomes.

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